LEGISLATIVE
AUDIT
COMMISSION

Review of
Department of the Lottery
Year Ended June 30, 2000

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REVIEW: 4140
DEPARTMENT OF THE LOTTERY
YEAR ENDED JUNE 30, 2000

FINDINGS/RECOMMENDATIONS - 4

NOT ACCEPTED - 1
ACCEPTED - 1
IMPLEMENTED - 2

REPEATED RECOMMENDATIONS - 0

PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 3

This review summarizes an audit of the Department of the Lottery for the year ended June 30, 2000, filed with the Legislative Audit Commission February 28, 2001. The auditors conducted a financial and compliance audit, and stated the financial statements were fairly presented.

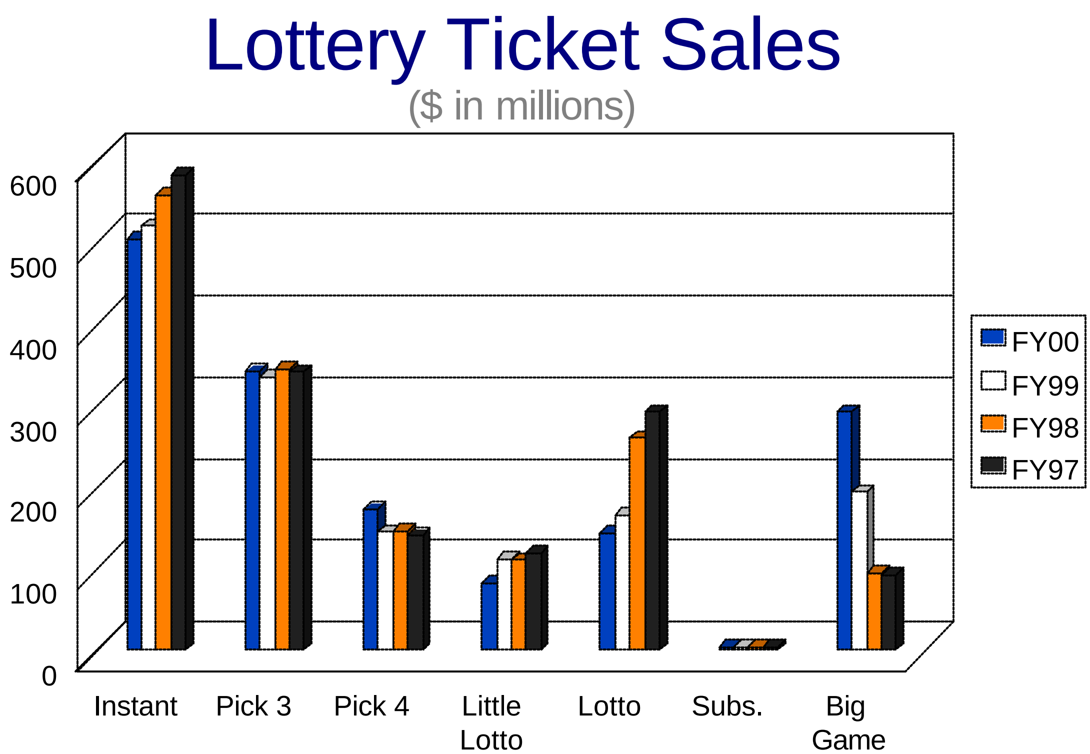
The Illinois State Lottery Act established the Illinois State Lottery Division within the Department of Revenue. The purpose of the division was to implement and establish within the State of Illinois a lottery to be operated by the State, the net proceeds of which are used for the support of the State's General Revenue Fund, and, effective during FY86, the Common School Fund. The Lottery was further intended to curb illegal gambling. In July 1986, the Lottery was separated from the Department of Revenue and established as the Department of the Lottery.

For the one-year period under review, Lori S. Montana served as Director of the Department. She was appointed to the position in March 1997. Prior to her initial appointment, she was not employed by the Department.

The number of employees at June 30 of the following years was:

	2000	***1999***
Lottery Control Board	5	5
Administrative, Financial, & Marketing	236	240
Electronic Data Processing	51	52
TOTAL	**287**	**292**

Ticket Sales and Commissions



Three of the six lottery games realized a decrease in sales in FY2000 compared to FY99. Instant sales decreased by $15.1 million, or 2.9%. Pick Three sales increased by $6 million, or 1.7%. Pick 4 sales increased by $27.7 million, or 19.2%. Little Lotto sales decreased $29.5 million, or 26.4%. Lotto sales decreased $22.3 million, or 13.4%. The Big Game increased $25.8 million, or 13.3%. Subscriptions were down $172,000. Overall, sales receipts in FY2000 were $1,466,595,782, down $7.5 million compared to FY99. Sales receipts in FY98 were $1,517 million and $1,569 million in FY97.

Lottery proceeds transferred to the Common School Fund are as follows:

FY00 - $537 million; FY99 - $519 million; FY98 - $537 million; FY97 - $583 million.

The highest transfer was recorded in FY92 when the Lottery proceeds to the Common School Fund were $612 million. The amount of income transferred to the Common School Fund is a function of when players claim their prizes. During FY2000, there was a larger number of players who did not claim their prizes until after fiscal year-end. Therefore, there was more cash available at the end of the year to be transferred.

In addition to the prizes and administrative expenses paid from appropriated funds, expenses and prizes are paid from Lottery proceeds in the hands of agents, distributors, and independent contractors. These amounts were:

	FY2000	***FY99***
Commissions deducted by agents, distributors, and independent contractors	$ 97,888,483	$ 98,386,565
Prizes paid by agents	542,846,296	522,714,910
TOTAL	**$ 640,734,779**	**$ 621,101,475**

Expenditures From Appropriations

The General Assembly appropriated a total of $364,480,700 from the State Lottery Fund to the Department of the Lottery for the year ended June 30, 2000. Of this amount, $237,969,343 was for payment of prizes, and $59,929,489 for the operations of the Department. Appropriated expenditures for payment of prizes (in addition to those paid from lottery proceeds in the hands of agents), increased by $5.2 million (from $232.7 million to $237.9 million) from FY99 to FY2000. Expenditures for the Department's operations decreased from $65,130,072 in FY99 to $59,929,489 in FY2000, an increase of $5.2 million or 8%. Appendix A provides a summary of the appropriations and expenditures for FY2000 and FY99.

Financial Statements

The table appearing in Appendix B presents the balance sheets for the Department. The balance sheet stood at $1,452,674,395 as of June 30, 2000, compared to $1,824,943,182 as of June 30, 1998. Appendix C is a summary of net revenues for FY2000 and FY99. Net income increased from $524,809,384 in FY99 to 532,125,794 in FY2000, largely due to a decrease in prize money paid and claimed in FY2000.

Accounts Receivable

Appendix D provides a summary of accounts receivable. Net accounts receivable stood at $9.7 million as of June 30, 2000 compared to $8 million at June 30, 1999. Of the total accounts receivable, $3,436,265 is from inactive agents. The Department expects to receive almost 77% of accounts receivable, less $2,984,830 for doubtful accounts. The increase in doubtful accounts from FY99 to FY2000 is due to a change in the method used in calculating doubtful accounts. Previously, doubtful accounts were estimated as a percentage of sales. The new method utilized the aging of accounts receivable.

Property and Equipment

Appendix E contains a summary of the property and equipment for which the Department was accountable during the period under review. Property and equipment decreased from $5,012,051 as of June 30, 1999 to $4,957,935 as of June 30, 2000. Of the $4,957,935 balance as of June 30, 2000, $1.8 million is attributable to automobiles, and the balance is equipment.

Deferred Lottery Prize Winners

Effective July 30, 1985, the State statutes provide that the State Treasurer may, with consent of the Director of the Department of the Lottery, contract to invest in securities which provide payments corresponding to the Lottery's obligation to winners. The State Treasurer transfers annual maturities of investment to the Deferred Lottery Prize Winners Trust Fund to finance installment payments to prizewinners. The Lottery vouchers and disburses these installment payments to prizewinners. At June 30, 2000, the payments aggregated to approximately $1,668,766,945 for Lotto, $41,813,000 for Lotto 7, $45,669,000 for instant games, and $100,020,000 for the Big Game. These securities were purchased at discount rates ranging from 5.7% to 10.89%. The present value of these future installments discounted at the rate in effect at the time of purchase was $1,243,064,746 at June 30, 2000. Shown in Appendix F is a summary of activity in the Deferred Lottery Prize Winners Trust Fund.

Accountants' Findings and Recommendations

Condensed below are the four findings and recommendations included in the audit report. Two of the recommendations were repeated from prior audits. The following recommendations are classified on the basis of information provided by Brett Finley, Chief Internal Auditor, in a letter dated May 16, 2001.

Not Accepted

1. Comply with the Procurement Code and award contracts for professional and artistic services using the competitive request for proposal process.

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Findings: The Department did not comply with the Illinois Procurement Code provisions for sole source procurements. The Lottery contracts with three separate accounting firms to conduct and observe the mid-day and evening drawings. Under the Purchasing Act, the Lottery was exempt from the competitive selection requirements. However, when the new Illinois Procurement Code (Code) became law in July 1998, the Lottery lost this exemption. Two of the firms' contracts have since expired, and rather than competitively awarding the new contracts, the Department improperly utilized the sole source provision of the Code.

The Lottery's written justification stated, "In view of the fact that the integrity and well being of the Lottery is based on the game drawings being performed without compromise and [the firm's] experience in performing the highly procedural process, rates charged by this company are below standard billable rates for these services, it is in the best interest of the Lottery and a sole source procurement is appropriate and authorized."

The auditors stated that the Lottery contracts with more than one accounting firm to conduct the drawings and this contradicts the statement that there is only one economically feasible source for the contract. In addition, the conducting of lottery drawings by public accounting firms is not unique to the State. At least 13 other states use independent auditors and four of the Big Five national auditing firms were among the firms being used. Therefore, there are other firms that have the necessary experience or ability to oversee drawings. The drawing procedures are not complicated enough to warrant use of the sole source provision.

Response: The Lottery disagrees with the finding and considers itself to be in full compliance with the Code. The Code states that the determination as to whether a procurement shall be made as a sole source shall be made by the procurement officer of the agency. This determination was based on compatibility of equipment and service, integrity of the drawing, use of procedures in the event of an irregular drawing, experience in conducting the live drawing, and availability of senior officials within the firm to officiate the live drawing.

The Lottery followed the Code in every aspect of these contracts. The Lottery posted on the Illinois Procurement Bulletin as a sole source. The Agency's procurement officer, aided by its internal panel, considered with diligence the conditions of sole source before concluding that compatibility of service was a paramount consideration. By law, only this Lottery official is entrusted to make this determination. The Lottery further notes that the range of rates was from $69-$93/hour, and were considerably below prevailing rates for senior officials in a large accounting firm.

Auditor Comments: The fact that the Code allows the procurement officer to make procurement decisions does not mean that these decisions are not subject to review by the General Assembly, the Governor, other governmental officials, and the citizens of the State.

Because the firms are required to rotate personnel assigned to the drawings weekly, and no one person can serve more than four weeks a year, staff actually performing the contracted services are frequently changed and "compatibility of service" is not necessarily achieved by maintaining the same firm on the engagements. The Lottery contracts with more than one accounting firm to conduct/observe drawings which weakens the argument that there is only one economically feasible source for the contract. Finally, the Lottery has very detailed on-line drawing procedures that would facilitate another firm's following the Lottery's requirements. Assigned auditors undergo on-site training prior to being assigned drawing responsibilities.

Accepted

4. Enter employee attendance records into the system properly and have supervisors approve all timesheets.

Findings: Time and attendance records were not properly maintained or properly entered. For seven of 20 employees tested, the amount of personal days used was incorrectly entered. Two of 20 timesheets tested had not been signed by the employee's supervisor.

Response: Accepted. The Lottery will emphasize the importance of properly entering attendance records into the system and will periodically review entries for accuracy. Timesheets will be appropriately approved.

Implemented

2. Notify Payroll Department of all employees assigned a State vehicle and properly tax them on this fringe benefit.

Findings: The Department did not have proper controls in place to ensure the "personal use of a State vehicle" is treated as a taxable fringe benefit for all employees who received the benefit. Out of the 25 employees tested, two were not taxed on the fringe benefit, nor was the value of having the care added to their wages.

Response: Implemented. The Lottery has procedures in place to ensure the Payroll Unit is notified of all employees who are assigned a State vehicle and properly tax them for this fringe benefit.

3. Ensure that deserving agents are paid their bonuses.

Findings: A total of $17,058 of agent bonuses to 23 agents was not paid as required. The Lottery stated that agent bonuses normally are automatically vouchered; however, bonuses for game show winners are manually vouchered. Department oversight caused two game shows to not be manually vouchered.

Response: Implemented. Subsequent to this occurrence, the Lottery automated the process of vouchering agent bonuses for game show winners. These types of bonuses are no longer applicable because the game show has ended.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1), states that "the principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts ..." The law recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services or to insure the integrity of State records. The chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY2000, the Department filed two affidavits for emergency purchases totaling more than $5 million. One emergency purchase was for $4.7 million to continue an advertising contract. The Department stated there was insufficient time to bid the contract. The other emergency purchase for $271,000 was to extend a point of sale contract until an RFP could be prepared.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State agency is required to file reports of all of its officers and employees for whom official headquarters have been designated at any location other than that at which their official duties require them to spend the largest part of their working time.

The Department of the Lottery indicated as of July 15, 2000, the Department had 68 employees assigned to locations other than official headquarters.

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